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Report of the Fourth International Insolvency Law Colloquium (Vienna, 16-18 December 2013)

Note by the Secretariat

Contents

		Paragraphs	*Page*
I.	Introduction	1-2	2
II.	Topics discussed	3-31	2
	A. Remaining elements of the current mandate of Working Group V	3-15	2
	B. Possible future work	16-29	6
	C. Mandated future work	30-31	10
III.	Summary and conclusions	32	10

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I. Introduction

1. At its forty-sixth session (2013), the Commission decided that Working Group V should hold a colloquium in the first few days of the working group session scheduled for the second half of 2013 to clarify how it would proceed with the enterprise group issues and other parts of its current mandate and to consider topics for possible future work, including insolvency issues specific to micro, small and medium-sized enterprises (MSMEs). The conclusions of that colloquium were not to be determinative, but were to be considered and evaluated by the Working Group in the remaining days of that session, in the context of the existing mandate. Topics identified for possible future work were to be reported to the Commission in 2014.[1]

2. The first three days of the forty-fourth session of the Working Group (16-18 December) were devoted to the colloquium, which considered issues relating to remaining elements of the existing mandate, topics for possible future work and issues already mandated for future work. Following the colloquium, the Working Group convened on 19 and 20 December (the report of the Working Group's deliberations on those two days is contained in A/CN.9/798).

II. Topics discussed

A. Remaining elements of the current mandate of Working Group V

1. Facilitating the cross-border insolvency of multinational enterprise groups

3. The first panel focused on what has been achieved thus far in Working Group V regarding the insolvency of enterprise groups, why part three of the Legislative Guide on Insolvency Law (the UNCITRAL Legislative Guide) focuses on the means of cooperation in the context of international groups, whether additional work could be done, and if so, what that work should be. Some of the specific issues discussed included:

(a) The focus of the recommendations in part three and the reasons for not including recommendations on group centre of main interests (COMI) or a coordination centre, and whether such concepts could now be developed;

(b) Issues such as applicable law and enterprise groups, that while included in the UNCITRAL Legislative Guide recommendations, do not have the same impact as they would if they had been addressed in the Model Law;

(c) The revision of the Guide to Enactment of the Model Law on Cross-Border Insolvency (the UNCITRAL Model Law) and how the COMI factors identified for individual debtors might be applied to enterprise groups;

(d) How the Model Law might be developed to address enterprise groups;

(e) The cultural, legal and commercial differences in insolvency regimes across jurisdictions that lead to different approaches to insolvency and procedural

[1] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 325.

and substantive differences between insolvency laws, creating problems of compatibility, increased costs and making control over all of the entities in the group difficult to exercise and coordinate;

(f) The benefits of speed and simplicity at the time of commencement of an insolvency proceeding (for example, need to avoid potentially lengthy litigation over identification of a parent, especially in groups where there may be more than one or location of the group COMI, etc.);

(g) The advantage of giving broad standing to all group members in proceedings concerning group members; and

(h) Mandating use of the coordination provisions of the UNCITRAL Model Law to ensure their enforceability and the use of protocols (possibly making them legally binding agreements) by the insolvency representatives at an early stage of the proceedings.

4. Consideration of those issues led to the proposal of a range of possible solutions, that might include: legally binding and enforceable pre- and post-commencement cooperation agreements between the various office holders; a focus on head office function rather than COMI or establishment to achieve some level of centralization in appropriate cases; use of synthetic secondary proceedings; use of living wills; greater use of substantive consolidation, reasonably applied; development of the recommendations in part three of the Legislative Guide and the articles of the Model Law into a more enforceable type of instrument; and binding arbitration agreements to deal with specific cross-border disputes.[2]

2. Model law or convention on selected international insolvency issues (including choice of law issues)

5. The second panel focused on that part of the Working Group mandate referring to the possible development of a model law or provisions on insolvency law addressing select international issues, including jurisdiction, access and recognition, in a manner that would not preclude the development of a convention. The purpose and benefits of elaborating an international convention on cross-border insolvency were considered, including the benefits of such a treaty as compared with a model law, such as a greater degree of harmonization of law and the binding effect of a treaty. The content of such an instrument might include: granting foreign insolvency representatives access to courts; recognition of foreign insolvency proceedings; cooperation and communication between representatives and insolvency courts; direct competence for the commencement of insolvency proceedings; and applicable law. The starting point for such an instrument would be the UNCITRAL Model Law, along with the recommendations in the UNCITRAL Legislative Guide, taking into account work by relevant international and regional organizations, such as the Hague Conference on Private International Law and the European Union.

6. With respect to choice of law, it was suggested that clear and predictable rules would assist in the administration of cross-border bankruptcy cases in a world where harmonization of bankruptcy procedures is incomplete, and where important local policy choices are influenced by commercial activity. The UNCITRAL Model

[2] See Report of Working Group V (Insolvency Law) on the work of its forty-fourth session, A/CN.9/798, para. 16.

Law, the European Council (EC) Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings (the EC Regulation) and the UNCITRAL Legislative Guide all seek to implement the administration of a debtor's insolvency across national boundaries through an administratively coordinated case based at the debtor's COMI. This procedural centralization leaves open the issue of which legal questions will be determined by the choice of forum (lex fori) and which will be left to the ordinary choice of law principles (*lex situs*). The Model Law is silent on this question, while the EC Regulation (Article 4) and the Legislative Guide (Recommendations 30-31) take an approach that (while not identical) give fairly broad application to the insolvency law of the debtor's COMI.

7. Recently proposed amendments to the EC Insolvency Regulation suggest that a different approach may be emerging, where the main case is authorized to engage in a choice of law inquiry to locate claims and assets and give effect to the local laws of other jurisdictions where a secondary or ancillary proceeding could be, but has not been, opened. This approach is sometimes called virtual territoriality or a synthetic secondary.

8. Within the current mandate of the Working Group, some adjustments could be made to recommendations 30 and 31 of the Legislative Guide, and an addendum to the Model Law might be considered. As noted above, a convention might include provisions dealing with choice of law. It may also be possible to consider developing a text that would seek to more generally articulate choice of law principles applicable to cross-border cases, again, in consultation with relevant international and regional organizations.

9. A further issue concerned recognition and enforcement of a discharge ordered in foreign insolvency proceedings. It was noted that recognition and enforcement of foreign insolvency-related judgements would be discussed in a later panel.

3. Insolvency of large and complex financial institutions

10. The panel provided an overview of what the Financial Stability Board (FSB) has done and is doing to address obstacles to cross-border resolution, including the development of a framework for expedited recognition of foreign resolution measures, adapted to the new set of tools contained in the FSB Key Attributes of effective resolution regimes for financial institutions (the Key Attributes). That recognition framework, building upon Key Attribute 7.5 and covering both statutory and contractual options, is one of the FSB priorities for work in 2014.

11. The panel also considered developments with respect to resolution tools and recognition frameworks in several jurisdictions. In respect of one jurisdiction's cross-border recognition framework, the panel noted why a recognition regime was important, the parties who might be entitled to seek recognition, the authority competent to recognize, and what might be covered by that recognition. It was also noted that that approach was not inconsistent with the Model Law, but that whereas the Model Law provided for rapid recognition and relief, those characteristics were seldom necessary in the case of banks and financial institutions.

12. Given UNCITRAL's experience in developing the Model Law, which represented a milestone in terms of cross-border recognition, it was suggested that UNCITRAL might have an important role to play in sharing and disseminating information on, and possibly developing and promoting, a broadly acceptable model

for recognition of cross-border insolvency of financial institutions and in ensuring consistency between insolvency regimes generally and insolvency regimes for bank and financial institutions.[3]

4. Obligations of directors of enterprise group companies in the period approaching insolvency

13. Some of the issues considered in the context of the obligations of directors of enterprise group members in the period approaching insolvency included whether: (a) directors should be allowed to pursue the group interest in the vicinity of insolvency, or only the interests of their own entity; (b) pursuing a group interest could be regarded as a possible step to minimize or avoid insolvency in accordance with recommendations 255-256 of part four of the Legislative Guide; (c) directors could use the group context as a defence against a wrongful trading claim; (d) the steps required of directors or controllers by part four of the Legislative Guide in the vicinity of insolvency would be sufficient when considering certain group managerial structures; (e) harmonization (of directors' obligations in a group context) would be desirable; and (f) conflict of laws aspects could be addressed.

14. Some of the background factors to be taken into account in considering these issues included: (a) the interaction between multiple entities of an enterprise group; (b) the potentially conflicting business purposes of different group members; (c) divided loyalties among members of the group; (d) the potential personal liability of a director acting for a member of the group; (e) intersection of civil and common law; (f) distinctions between independent directors and those with ownership interests; and (g) the importance of adopting solutions that promote trade and commerce.

15. Various ways of approaching these problems were suggested including: (a) adopting the approach in part three of the Legislative Guide of taking account of various factors associated with the group context, such as those indicated with respect to avoidance of intra-group transactions, procedural coordination and conflicts of interest where one insolvency representative is appointed to multiple insolvency estates; (b) considering the solutions provided in part four of the Legislative Guide where companies related to the debtor can be considered shadow or de facto directors;[4] (c) adopting an approach that would enable those whose interests are at stake in insolvency (e.g. creditors) to monitor and influence the behaviour of controlling entities and those in control of those entities in order to better align their mutual interests; (d) adopting different ways of addressing conflicts of duties by allowing conflicted directors to resign or to follow the guidance of their controlling entity and not be exposed to liability if they do so; (e) identifying situations in which a business judgement rule should operate in order to promote the idea that relatively prudent behaviour will be protected; and (f) revisiting the recommendations in part four of the Legislative Guide to see how they might be adjusted to address enterprise groups.[5]

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[3] Ibid., paras. 21-22.

[4] UNCITRAL Legislative Guide, part four, chap. II, paras. 13-16.

[5] See Report of Working Group V (Insolvency Law) on the work of its forty-fourth session, A/CN.9/798, paras. 23 and 30.

B. Possible future work

1. Issues relating to creditors and claims

Part 1: Treatment of priority and "unusual" cross-border claims

16. A number of issues with respect to cross-border priority claims were discussed, including: (a) whether a universalist or a territorial approach should be adopted (e.g. whether priority claims against a company located in and subject to insolvency proceedings in a foreign jurisdiction should be admitted in those proceedings even though the claims do not originate in that jurisdiction; and if they are allowable claims, whether they should be afforded the ranking accorded in the jurisdiction in which they originated); (b) balancing the competing interests of foreign priority creditors and local creditors (e.g. how an admissible claim with a particular ranking in one jurisdiction would be treated in another jurisdiction where the same claim would be inadmissible or have no priority); (c) how unexpected claims might be addressed, especially if they were so large as to exhaust the insolvency estate; and (d) the injustices that would occur or advantages that would be lost if cross-border priority issues were not resolved.

17. Possible solutions included establishing a universal set of priorities; recognizing foreign priorities in local proceedings unless contrary to public policy; marshalling assets to one main proceeding, where a group trades as a single entity (e.g. as in the cases of *Nortel Networks* and *Lehman Brothers*); ignoring the separate legal status of group members and treating the group as a single enterprise; and leaving it up to local law and considerations.

Part 2: Relative voting rights of debt and equity holders and the impact on forum selection

18. Five elements were discussed, the first being shareholder approval problems. These included: inconsistent rules for plan approval might apply in parallel proceedings concerning a single entity and in proceedings pending in different jurisdictions concerning multiple members of the same group. The second element was problems associated with cramdown provisions, for example: a law with stronger cramdown and lower barriers to cramdown would give leverage to the plan proponent (often the debtor) and a law with no provision for cramdown would require unanimous consent of all creditors, and thus give complete power over the terms of reorganization to any holdout creditor. The third element was secured creditor participation where insolvency regimes adopt different approaches to: imposition of a "stay" on secured creditor enforcement actions, realization of property subject to secured claims by the insolvency estate, and alteration of the rights of secured creditors. The fourth element was different approaches to insider subordination; many jurisdictions treat insider claims by subordinating their recovery rights below the rights of unsecured creditors, and some jurisdictions automatically treat insider creditor claims as equity claims. The final element was the participation of creditors who would not receive any distribution in the insolvency ("out of the money" creditors), given that some regimes do not permit them to vote on plans, and others do not permit them to object to certain actions.

19. The panel noted that all of these elements can influence forum selection, which may allow some stronger creditors to maximize their potential for recovery at

the expense of a much larger constituency of other stakeholders. It was suggested that forum selection might be addressed through a number of means including: harmonizing the elements that tend to affect forum selection most critically; setting international standards for forum selection; and rewarding or punishing forum selection choices.

Part 3: Coordinating creditor access to information and representation

20. A common goal among insolvency regimes is maximizing creditor recoveries. A related goal is, or should be, providing creditors access to information to allow them to participate and protect their interests in a proceeding. It was suggested that approved creditor committees could play a beneficial role in providing greater access to information for all creditors, presenting issues of similarly situated creditors and increasing efficiency.

21. Various additions to recommendations 126-136 of the Legislative Guide were proposed to provide more information on notice to creditors, both known and unknown (e.g. concerning opening of proceedings, location and value of assets, status of proceedings, disposition of assets and payment of claims), cooperation (e.g. between insolvency representatives and creditors or creditor representatives, and in concurrent proceedings where creditor groups exist, between creditor groups), and access to insolvency regimes (e.g. ease of creditor access to administrators or courts to assert claims or issues, and ensuring consistency and simplicity of procedures for filing creditor claims). A further issue concerned representation of creditors by insolvency representatives, including the right of the insolvency representative to lodge claims and vote in domestic and foreign proceedings. Addition of further material to the Guide to Enactment and Interpretation concerning article 27 of the Model Law to address some of these concerns was also thought to be appropriate.[6]

2. The insolvency treatment of financial contracts and netting

22. The panel presented the work of several international organizations with respect to close-out netting, including the Unidroit Principles on Close-Out Netting and the relevant aspects of the FSB Key Attributes of effective resolution regimes for financial institutions, as well as the impact of close-out netting on risk management and systemic risk. The relevant recommendations of the UNCITRAL Legislative Guide were compared to the Unidroit Principles, and it was noted that the approach adopted by the recommendations of the Legislative Guide was much wider and unrestricted than that of the Principles (e.g. the Legislative Guide does not limit who may be party to a financial contract, whereas the Principles exclude natural persons acting primarily for personal, family or household purposes). Since the global financial situation has changed significantly since the adoption of the Legislative Guide in 2004, particularly as a result of the 2008 global crisis, it was suggested that that approach may no longer represent best practice. Moreover, because the recommendations of the Legislative Guide (together with the World Bank's Principles for Effective Insolvency Systems) form the international standard used by the World Bank and International Monetary Fund in assessing national insolvency regimes, it is of particular importance that those recommendations

[6] Ibid., paras. 25 and 30.

represent current best practice. It was suggested that the relevant parts of the Legislative Guide be updated in light of these factors and of work carried out in the interim by other international organizations.[7]

3. Regulation of insolvency practitioners

23. The panel presented the Insolvency Office Holder Principles prepared by the European Bank for Reconstruction and Development (EBRD), and discussed why countries would benefit from implementing the Principles and how they might do so. It was noted that studies suggest a strong correlation between the qualifications of insolvency practitioners and insolvency regimes with higher returns to creditors, as well as higher levels of available credit and better performance by courts in insolvency matters. Experience with implementation of the EBRD Principles suggests that because different countries have different needs, especially where public institutions are broken and the private sector lacks expertise, there may be a range of different ways of improving the quality of insolvency professionals, from developing codes of ethics to State-sponsored licensing and disciplinary regimes. Examples were cited of some of the problems encountered in insolvency proceedings, particularly in the cross-border context, in which inexperienced and unqualified insolvency practitioners had been appointed. The EBRD Principles, together with other work by relevant international organizations (e.g. International Association of Insolvency Regulators and the World Bank), might serve as a reference for expanding the existing material in the Legislative Guide to provide a basis for countries to prepare appropriate regulatory regimes. It was indicated that this might be a topic that could be developed informally by a group of experts before being considered by the Working Group.[8]

4. Enforcement of insolvency-derived judgements

24. The panel discussed a recent judgement of an English court concerning the recognition and enforcement of foreign insolvency-derived judgements (specifically, transaction avoidance) under the Model Law, the position likely to be taken by the courts in another country, the position under the EC Insolvency Regulation with respect to that issue, as well as the position in Europe with respect to recognition of non-European decisions. Although the English decision has created some uncertainty as to whether such recognition and enforcement is covered by the Model Law, in other jurisdictions the approach taken by the courts has been more flexible and has recognized that the traditional rules for recognition and enforcement of insolvency-derived judgments must adapt to changing conditions.

25. Some concern has been expressed that the judgement may limit the effectiveness of the Model Law and weaken arguments for its adoption; that it seems inconsistent to recognize the foreign proceedings and the appointment of the insolvency representative, but not to recognize insolvency-derived judgements; that the approach may spread to other insolvency-derived judgements; and that it marks a retreat from the modified universalism of the Model Law. The panel noted that such judgements would be recognized and enforced under the EC Insolvency

[7] Ibid., paras. 26 and 30.

[8] Ibid., paras. 27 and 30.

Regulation; outside the EC Regulation, the position in Europe varies with respect to recognition of non-European decisions.

26. It was suggested that article 21 of the Model Law might be amended so that it is clear that the discretionary relief the court can grant in aid of foreign insolvency proceedings includes the ability to recognize and enforce an "insolvency-derived" judgement of a foreign insolvency court. Another view was that the problem could probably be confined to the particular jurisdiction and did not require a general solution.[9]

5. Insolvency treatment of intellectual property in cross-border insolvency cases

27. The panel noted that intellectual property is becoming increasingly important in insolvency cases, and in some instances those rights constitute the majority of the assets of an insolvent company. Even where the intellectual property does not constitute a large portion of the assets, the intellectual property rights may be critical to the ability of the debtor to function. However, if the debtor is the licensor of intellectual property rights and can terminate the rights of licensees, the termination of those licences may have major ramifications as the whole chain of licensees and their suppliers and other creditors will be affected.

28. The panel considered differing approaches to various issues focusing on what happens to the rights and obligations of licensees and licensors of intellectual property upon commencement of the insolvency of either of them in a number of different jurisdictions and pursuant to current guidance found in the Legislative Guide on Insolvency Law and the Supplement on Security Rights in Intellectual Property to the UNCITRAL Legislative Guide on Secured Transactions. It was noted that while the work UNCITRAL had done to date had addressed some of the issues to some extent, neither of those texts included recommendations on specific intellectual property issues in insolvency.

29. Since intellectual property is the type of property that easily crosses national borders, it was suggested that harmonization of the treatment of intellectual property rights in insolvency proceedings should be addressed. The treatment of intellectual property rights in multinational insolvencies is complicated by differences in the underlying intellectual property law. The impact of several court decisions in cross-border insolvency cases involving questions of intellectual property law formed part of the discussion. Treatment of intellectual property rights in the enterprise group context is also an issue; for example, one subsidiary may own the intellectual property rights of the entire group. It was noted that the Legislative Guide adopted a general approach to relevant topics, for example, the treatment of contracts in insolvency, and did not provide detailed treatment for specific types of contract or on possible exceptions to those general rules. On that basis, it was questioned whether detailed treatment for intellectual property contracts in the Legislative Guide was appropriate.[10]

[9] Ibid., paras. 28 and 30.
[10] Ibid., paras. 29 and 30.

C. Mandated future work

Expedited, simplified proceedings, including pre-packs and other mechanisms suitable for the insolvency of MSMEs

30. The panel noted that the Working Group already had a mandate to conduct, at its forty-fifth session in April 2014, a preliminary examination of relevant issues, and in particular to consider whether the Legislative Guide provided sufficient and adequate solutions for MSMEs. If it did not, the Working Group had been requested to consider what further work and potential work product might be required to streamline and simplify insolvency procedures for such enterprises. The panel presented an introduction to the global landscape for MSMEs, including their importance and prevalence in most economies, as well as some of the challenges they face, including their vulnerability to financial distress and reduced access to credit, markets, skills, infrastructure and government services.

31. The panel went on to consider MSME exit mechanisms, including the importance of such mechanisms, the key challenges faced in devising effective mechanisms, including means of funding those mechanisms, and possible solutions, noting the need to address the stigma often associated with insolvency in the MSME context. Elements of possible solutions identified included: discharge, fresh start, speed, low cost, simplicity and flexibility, as well as the need for the support of other laws, such as tax laws, an appropriate institutional framework, and possible use of informal mechanisms. Reference was made to one jurisdiction, which had given particular consideration to developing provisions tailored to MSME insolvency. Related measures such as the establishment of assistance and information centres for MSMEs, such as debt advisory services, were also noted.

III. Summary and conclusions

32. The colloquium concluded with a summary of the issues considered by each panel. Many of the problems associated with each of the topics covered by the panels had been clearly identified together with, in some instances, possible solutions. It was noted that there were significant synergies between various topics, that some of the same issues (e.g. choice of law) had emerged with respect to numerous topics, and that there was a need for the work of UNCITRAL to continue to reflect the most current best practice, even if that meant that existing texts had to be updated to respond to changed and changing circumstances. Moreover, some of the issues to be addressed were certain to require creative and forward thinking to keep pace with commercial reality, much like what went into the conception and preparation of the Model Law in the 1990s. Enterprise groups, for example, challenge traditional ways of thinking about business structures. In many instance, it was suggested, enterprise groups cannot realistically be regarded as collections of individual entities. Rather, they operate as single enterprises that are arranged as groups of individual corporate entities only to take advantage of current tax and other business realities. New ways of thinking needed to be developed in order to address the impact of the insolvency of such groups. It was noted that some of the topics discussed would require the Working Group to coordinate its efforts with those of other relevant international organizations.